PUBLIC ACT 286

A REVIEW AND ANALYSIS

Presentation to the
HOUSE ENERGY AND TECHNOLOGY COMMITTEE

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Overview

Public Act 286

Why, What, How, and Now

Situation Analysis (Post PA 141)

Policy Goals

Key Provisions of PA 286

Implementation of PA 286

Where we are today

Thoughts for consideration

Situation Analysis (Michigan Post PA 141)

- US unemployment rate was 5.0% in December 2007; whereas Michigan was 7.2%
- Compared to the 10 largest states, Michigan was benchmarked as having the fourth lowest average electricity rates for residential and industrial and third lowest for commercial
- From 2000-2008, employment in durable goods manufacturing plummeted 22.3%, compared to 9.9% nationally.

Situation Analysis (Michigan Post PA 141)

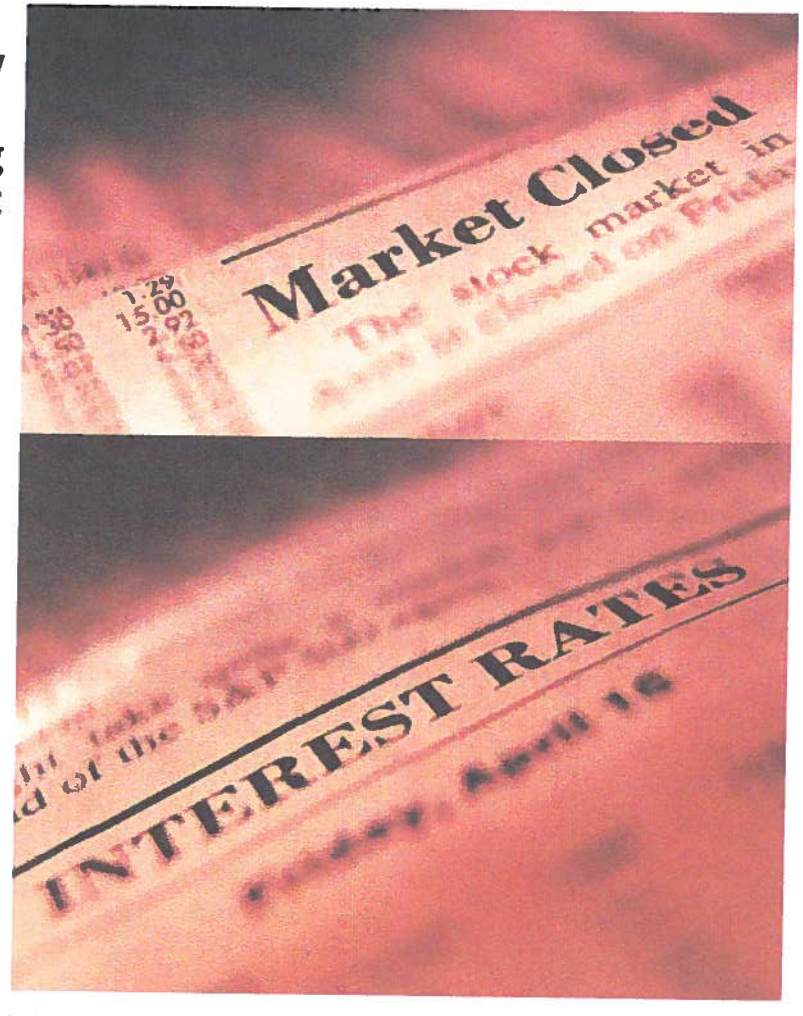
- 10, 625 MW New Capacity was designated as delayed – no operating date in sight
- PSC concerned about insufficient baseload, kicked off the capacity needs forum in Case U-14231.
- Aging infrastructure, average power plant age was 50 years
- In 2007, 4% of electricity sales in DTE and Consumers territories were served from AES's; down from 6% in 2006
- PSC staff study showed rate cases on average lasting 11.7 months.
- PSC staff reductions; yet facing significant rate filings – for 2004 over $2.5 billion in rate filing requests

Facility	Capacity (MW)	Status	Operating Date
Augusta Park	340	Delayed	Uncertain
Calpine Corp	900	Delayed	Uncertain
CME NA	1,100	Delayed	Uncertain
Dominion/CME	800	Delayed	Uncertain
Dominion/ERORA	600	Delayed	Uncertain
Hannahville	1,000	Delayed	Uncertain
Indeck Energy	1,100	Delayed	Uncertain
International Energy	300	Delayed	Uncertain
Mirant Wyandotte	550	Delayed	Uncertain
Nordic	850	Delayed	Uncertain
Panda Tallmadge	1,100	Delayed	Uncertain
New Covert	1,170	Completed	3/1/2004
Sempra	500	Delayed	Uncertain
Tenaska	880	Delayed	Uncertain

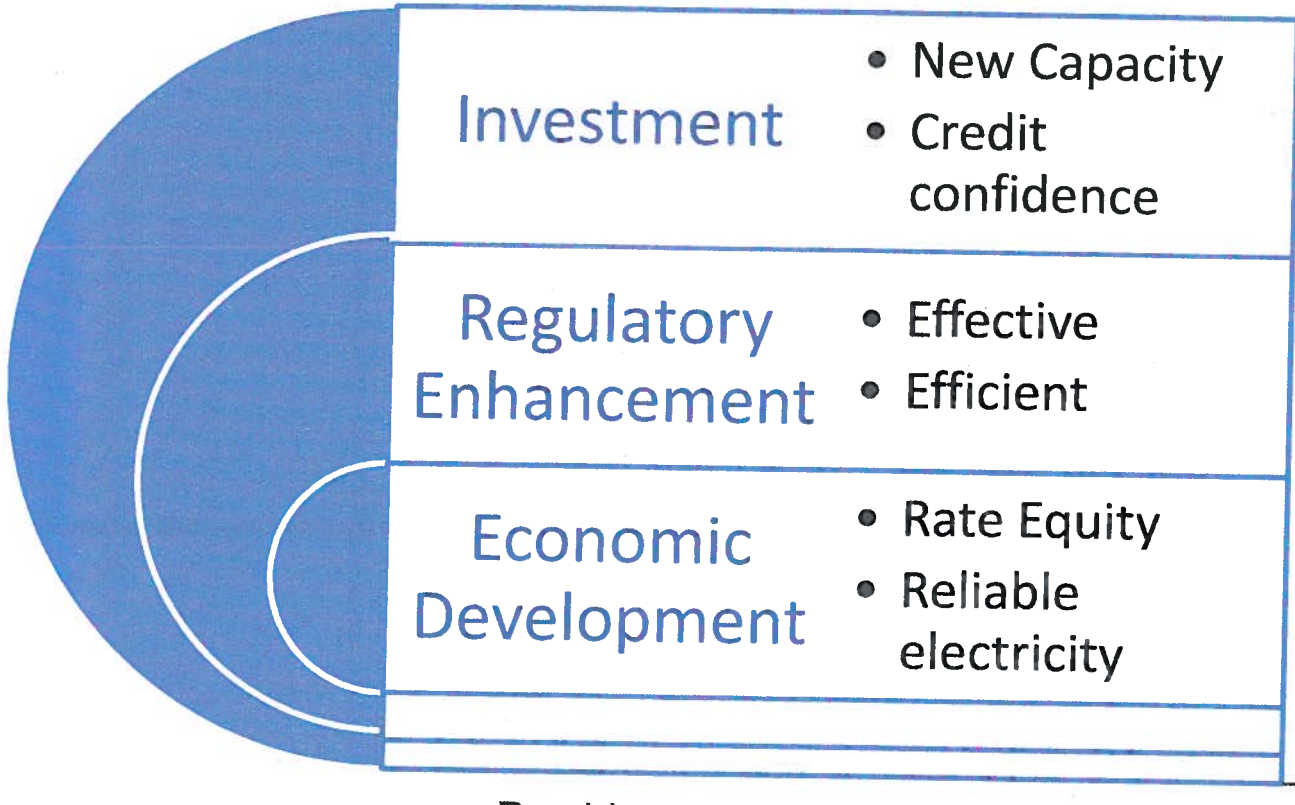
Source: http://www.dleg.state.mi.us/mpsc/electric/restruct/merchantplants.htm

Situation Analysis (Capital, Markets, Analysts)

- Fitch and other analysts and rating agencies opined that there was unlikely to be any new Michigan generation under a "hybrid system" as there were no assurances for long term recovery for either a utility or merchant generator
- Credit markets were beginning to tighten
- Nationwide, estimates begin circulating that between 2008 and 2030; $2 Trillion in capital would be needed for investment in the electric system
- Despite MISO day ahead markets beginning in 2005; wholesale markets were having little effect on helping to spur new capacity
- Cost of new power plants were significant in comparison to company market capitalization



Policy Goals for PA 286



Provide a regulatory process for new capacity to be built, but only if it is needed

Key Provisions of PA 286

Enhanced Regulatory Process

-12 month rate cases

-Self implementation

Merger & Acquisition Review

Got in line with other states – protecting customers

Retail Market set at 10%

Addressed market "hybrid concerns" – yet kept a retail option at nearly 3 times existing usage

Certificate of Need Process

-Integrated Resource Plan for reliability

-Investment preapproved, only if Needed

-Lower cost of capital

Rate Realignment

-Undo 1970s historical subsidized rate treatment

-50-25-25 cost allocation was adopted

PA 286

- **Passed on a bi-partisan basis**
- **2 year discussion and study**
  - All parties included in workgroups/sessions
- **Most sweeping reform in the nation**
- **Attempted to bridge concerns from all sides**
- **Tackled pressing issues raised by financial communities**
- **Tie Barred to PA 295**

Implementation of PA 286

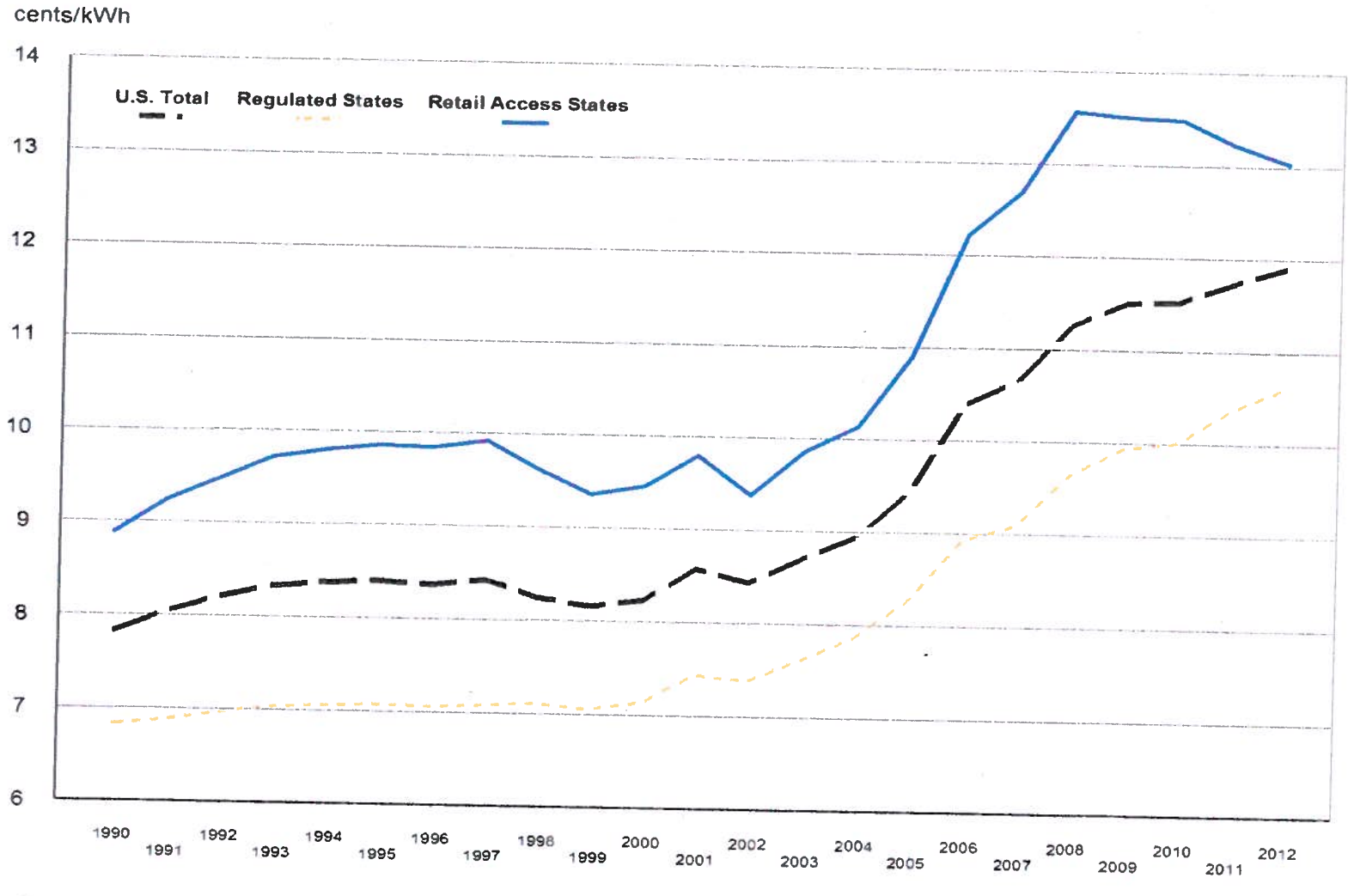
- Cost of Service Rates are set to be in place by the end of this year (2013)
- Rate cases
  - Have been processed in 12 month timeline
- Certificate of need (AEP plant expansion; anticipate that CMS will be filing shortly for their proposed natural gas plant)

"Traditional" regulation vs. deregulation

- The strengths of traditional regulation have been long-term reliability and stable pricing but by averaging rates utilities have not always been responsive to changes in the market.

- The strengths of the deregulated model is the flexibility certain customers have to take advantage of favorable market trends but is not well suited to assume the risks associated with large capitol investments necessary to build new generation.

Weighted annual averages for all states, regulated states and states with open retail access (1990 through 2012)



- Data source: DOE/EIA (from the presentation by Ken Rose).

Weighted annual averages for all states

Year	Regulated States	Deregulated States	U.S. Total
1990	6.85	8.85	7.83
1991	6.91	9.36	8.08
1992	6.95	9.46	8.24
1993	7.04	9.68	8.31
1994	7.06	9.73	8.35
1995	7.07	9.8	8.4
1996	7.04	9.75	8.35
1997	7.07	9.85	8.43
1998	7.11	9.58	8.22
1999	7.06	9.45	8.18
2000	7.18	9.51	8.22
2001	7.44	9.71	8.55
2002	7.44	9.44	8.49
2003	7.64	9.85	8.71
2004	7.82	10.15	8.98
2005	8.36	10.97	9.53
2006	8.92	12.28	10.52
2007	9.18	12.72	10.71
2008	9.71	13.54	11.28
2009	9.91	13.51	11.47
2010	10.02	13.48	11.51
2011	10.43	13.25	11.68
2012	10.57	13.08	11.89
AVERAGE	**8.03**	**10.74**	**9.30**

Price Differences Between:

Regulated States and Deregulated States	Regulated States and U.S. Total	Deregulated States and U.S. Total
2	0.98	1.02
2.45	1.17	1.28
2.51	1.29	1.22
2.64	1.27	1.37
2.67	1.29	1.38
2.73	1.33	1.4
2.71	1.31	1.4
2.78	1.36	1.42
2.47	1.11	1.36
2.39	1.12	1.27
2.33	1.04	1.29
2.27	1.11	1.16
2	1.05	0.95
2.21	1.07	1.14
2.33	1.16	1.17
2.61	1.17	1.44
3.36	1.6	1.76
3.54	1.53	2.01
3.83	1.57	2.26
3.6	1.56	2.04
3.46	1.49	1.97
2.82	1.25	1.57
2.51	1.32	1.19

Impact of structural factors on rates in Michigan

The reasons Michigan has experienced a greater rate burden over the past four years are:

- Economic downturn
- Demand devastation
- Fuel costs
- State mandated costs (PA 295)
- EPA requirements
- Cost shifts due to open retail access

Public Good

- Economic theory supports government regulation to insure sufficient production of a public good.
- Electric reliability is a public good.
- Without sufficient investment in reliability, we will face drastic societal and personal consequences.

RELIABILITY

Insuring sufficient electric generation to meet future demand

"Electricity has been deemed to be an essential public service. Everyone is expected to have access to power to meet minimal health and safety needs... Regulated utilities have an 'obligation to serve' all customers with all the power they require" [Source: U.S. Department of Energy 2002, "A Primer on Electric Industry Restructuring"]

- The reliability of the system depends upon a delicate balance of supply and demand that varies throughout the day and throughout the year and will change over time.

- Huge base load generation plants reliably provide power output and is the foundation of the system supported by smaller peaker plants which provide power for marginal demand.

- The complex balance of base load and peaking power plants along with the introduction of RTO's have resulted in a very reliable electricity supply.

The Coming Crisis in Electricity Generation

- A perfect storm is fast approaching with the retirement of aging base load plants, a transition toward new and cleaner generation, and the return of load growth as the economy improves.
- The full extent of the challenge of meeting future capacity needs has not yet been experienced in most states.
- Where capacity has become an issue (i.e. Calif., Texas, Maryland and New Jersey), deregulation has proven to be ineffective.

Reliance on deregulation to meet short-term pricing needs will put long-term reliability at risk.

- Deregulation does not have the economic drivers to build the type of base load generation that will be needed to meet future need
- In a deregulated market, investments will be made for profit as opposed to ensuring long term reliability, sustainability, and stable cost to customers
- Integrated resource planning is lost under the deregulated model
- Deregulation focuses solely on the financial elements within the electric markets which by their very nature are regional versus state centered and price driven versus system integrity
- We must never let electricity become a speculative commodity

Responsible - Responsive – Reasonable
Regulation

- Provide consumer protection
- Quality standards for services
- Provider of last resort
- System planning, development and implementation
- System security and safety
- System reliability and sustainability
- Promote energy diversity
- Integrated resource planning
- Incentivize innovation
- Prevent environment degradation
- Insure predictable, stable and affordable rates

Thoughts for consideration

- State comparisons
- Rates
- Investment requirements
- Short term vs. long term goals
- Accountability